The New York Times

Fed Acts to Rescue Financial Markets

By Edmund L. Andrews

March 17, 2008

WASHINGTON — Hoping to avoid a systemic meltdown in financial markets, the Federal Reserve on Sunday approved a $30 billion credit line to engineer the takeover of Bear Stearns and announced an open-ended lending program for the biggest investment firms on Wall Street.

In a third move aimed at helping banks and thrifts, the Fed also lowered the rate for borrowing from its so-called discount window by a quarter of a percentage point, to 3.25 percent.

The moves amounted to a sweeping and apparently unprecedented attempt by the Federal Reserve to rescue the nation's financial markets from what officials feared could be a chain reaction of defaults.

After a weekend of intense negotiations, the Federal Reserve approved a $30 billion credit line to help JPMorgan Chase acquire Bear Stearns, one of the biggest firms on Wall Street, which had been teetering near collapse because of its deepening losses in the mortgage market.

In a highly unusual maneuver, Fed officials said they would secure the loan by effectively taking over the huge Bear Stearns portfolio and exercising control over all major decisions in order to minimize the central bank's own risk.

The Fed, working closely with bank regulators and the Treasury Department, raced to complete the deal Sunday night in order to prevent investors from panicking on Monday about the ability of Bear Stearns to make good on billions of dollars in trading commitments.

In a potentially even bigger move, the Federal Reserve also announced its biggest commitment yet to lend money to struggling investment banks. The central bank said its new lending program would make money available to the 20 large investment banks that serve as “primary dealers” and trade Treasury securities directly with the Fed.

Much like a $200 billion loan program the Fed announced last Tuesday, this program will essentially allow the government to hold as collateral a wide variety of investments that include hard-to-sell securities backed by mortgages. But Fed officials told reporters on Sunday night that the new program would have no limit on the amount of money that can be borrowed.

In a conference call with reporters, the Federal Reserve chairman, Ben S. Bernanke, said the central bank was moving to provide money to financial institutions that need it.

“The Federal Reserve, in close consultation with the Treasury, is working to promote liquid, well-functioning financial markets, which are essential for economic growth,” he said. “These steps will provide financial institutions with greater assurance of access to funds.”

It was unclear just how much risk the Federal Reserve was taking on, especially in the bailout of Bear Stearns. But analysts said it was clear that JPMorgan Chase was getting an extraordinary bargain, buying Bear Stearns at a tiny fraction of its market value just one week ago, and with the Fed shielding it from much of the risk.

Fed officials said they would take control of the investment holdings of Bear Stearns in order to maximize their value and minimize disruptions as a result of a cash squeeze. Without providing details, Fed officials insisted that the $30 billion loan was covered by even the most conservative estimates of the Bear Stearns holdings.

Mr. Bernanke spent much of the weekend in his office in Washington, staying in constant telephone contact with officials at the New York Fed, which led the negotiations with JPMorgan Chase. Mr. Bernanke and board officials in Washington set the overall parameters for how much risk the central bank was willing to shoulder, and they consulted closely with the Treasury Department and its Office of the Comptroller of the Currency.

But Mr. Bernanke had already been worrying for some time about the collapse of a major Wall Street bank, and Bear Stearns had been high on its watch list.

Standard & Poor’s 500 index futures expiring in June fell 2.9 percent on Sunday night, signaling a lower opening for United States stock markets on Monday morning.

Last Tuesday, the central bank announced a $200 billion loan program that would allow the nation’s biggest banks to borrow Treasury securities and post mortgage-backed securities as collateral. The financing gave 20 top investment banks 28-day loans at what amounted to wholesale rates — at or slightly below the Fed’s benchmark rate on overnight loans between banks.

But the program did little to rejuvenate the credit markets, which have been paralyzed by fears about even conservative short-term-debt securities. On Wall Street, rumors about a possible collapse of Bear Stearns, which had been a leader in packaging mortgage-backed securities, gained gale-force strength.

Monetary policy experts said they were stunned by the sweeping nature of the Fed’s efforts, which they said were unprecedented in a host of different ways. But some were doubtful about whether the moves would solve the underlying problem of huge losses from bad lending practices.

“Emergency provision of loans is necessary but not sufficient,” said Lawrence H. Summers, who was a Treasury secretary under President Bill Clinton. “There is a fundamental issue, which is that the financial system is short of capital and is under pressure to contract.”

Henry M. Paulson Jr., the current Treasury secretary, vigorously endorsed the Fed’s rescue efforts on Sunday and made it clear he was much less worried about the “moral hazard” of bailing out a Wall Street firm than he was about a chain reaction of defaults if Bear Stearns were to abruptly collapse.

“The right decision here, I am convinced, was the decision that the Fed made, which was to do things, work with market participants to minimize the disruptions,” Mr. Paulson said on “This Week With George Stephanopoulos” on ABC.

Mr. Paulson and two top deputies, Robert Steel and Anthony W. Ryan, stayed in Washington rather than participate in person with the talks under way in New York. But Treasury officials said they stayed in constant telephone contact with the New York Fed and with Wall Street executives.

The New York Fed, which runs the Fed's daily market operation and has long been the Federal Reserve's primary channel for dealing with Wall Street, led the negotiations with JPMorgan Chase.

The principal issue, according to officials, was how much insurance the Fed was willing to provide to JPMorgan Chase in exchange for taking over Bear Stearns and its hard-to-quantify assets.

Fed officials were racing to announce an agreement of some sort before financial markets opened in Asia, which meant reaching a deal on Sunday night. But even as they worked to engineer a takeover of Bear Stearns, Fed officials were canvassing executives at other Wall Street firms that might be in trouble as well.

As rumors about problems at Bear Stearns swept across Wall Street last week, Fed and Treasury officials became convinced that they needed more weapons to help struggling investment banks. Although stock investors initially cheered the announcement Tuesday of the $200 billion lending program, the credit markets showed little reaction — an indication that investors were still dubious about the mountain of mortgage-backed securities that companies like Bear Stearns were holding.